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PLR-121156-19

Date:

May 19, 2020

Foundation	=
X	=
Foreign Country	=
Grant Program 1	=
Grant Program 2	=
Collaborating Artist 1	=
Charity Regulator	=

Dear :

This letter responds to a September 2, 2019, request for rulings from your authorized representative, as supplemented by information submitted in a letter dated January 6, 2020, and an amended ruling request dated January 6, 2020. The request involves rulings under §§ 4941, 4942, and 4945¹ with respect to certain grants planned to be made by Foundation, as more fully set forth below.

FACTS

Foundation is a non-stock corporation recognized as an organization described in § 501(c)(3) and classified as a private foundation under § 509(a). Foundation's purposes include the advancement of the arts and art education, and increasing public access to a broader range of visual art. Foundation engages in a wide range of activities, including grant making. Foundation is a calendar year taxpayer.

¹ Sections 4941, 4942, and 4945 of the Internal Revenue Code of 1986, as amended, to which all subsequent "section" or "§" references are made unless otherwise indicated.

Grant Program 1

As part of Foundation's grant making activities, Foundation previously developed Grant Program 1, pursuant to which it provides grants to art galleries to fund the expenses related to their display (but not purchase) of art from relatively unrecognized artists ("Collaborating Artists"). A prior recipient of funding from Grant Program 1 used the funds to exhibit art created by Collaborating Artist 1.

Grant Program 2

Foundation now intends to establish Grant Program 2. Pursuant to Grant Program 2, Foundation will make grants to X, an organization located in Foreign Country. X will use the grants to make its own grants to museums, galleries, and other arts organizations ("Secondary Grantees") in Foreign Country. Grants from X to Secondary Grantees will fund purchases of works of art from Collaborating Artists for public display by Secondary Grantees.

Foundation represents that X is recognized by Charity Regulator as a national organization established under the laws of Foreign Country to acquire works of art and items of national historical importance for public display by other, local public institutions (such as Secondary Grantees). Foundation represents that both X and all of the Secondary Grantees are or will continue to be nonprofit organizations no part of the net earnings of which inure to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and which do not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office within the meaning of § 501(c)(3).

X has not applied for or received a determination letter from the Internal Revenue Service that it is an organization described in § 501(c)(3) or in § 4942(j)(3). Foundation has not made a good faith determination (as described in Treas. Reg. § 53.4942(a)-3(a)(6)(i)) that X is an organization described in § 509(a)(1), (a)(2), or (a)(3) or in § 4942(j)(3).

For each grant made to X, Foundation will enter into an expenditure responsibility agreement with X consistent with the requirements of § 4945(h) and Treas. Reg. § 53.4945-5. The expenditure responsibility agreement will provide that the grant funds awarded must be used exclusively for purposes described in § 170(c)(2)(B) and that X maintain the grant funds in a separate fund dedicated to one or more purposes described in § 170(c)(2)(B). The expenditure responsibility agreement also will provide that X will not use any of the funds to make any grant that would constitute a taxable expenditure within the meaning of § 4945(d).

Foundation represents that it will not earmark the use by X of any grant made to X pursuant to Grant Program 2 and that Foundation does not have any agreement, oral or

written, whereby Foundation may cause the selection of Secondary Grantees. X will retain discretion and control over the use of funds received from Foundation.

A Foundation representative will participate in the review of grant applications submitted to X by potential Secondary Grantees. The Foundation representative will have an advisory role only; the Foundation representative will recuse himself or herself from the final decision-making process and will not have any voting or similar privileges with respect to the awarding of any grants by X to any Secondary Grantees.

Foundation represents that neither it nor any disqualified person with respect to the Foundation controls (directly or indirectly) X or any possible Secondary Grantee within the meaning of Treas. Reg. § 53.4942(a)-3(a)(3).

Purchase of Art from Collaborating Artist by Disqualified Person

Prior to the submission of the request for rulings by Foundation, a director of Foundation ("Foundation Director") individually purchased three works of art from Collaborating Artist 1, whose work had been displayed by an art gallery supported by Grant Program 1 funding. Foundation anticipates that a Secondary Grantee may in the future also purchase one or more works of art from Collaborating Artist 1 using funds received from X, which funds will have been received by X from Foundation pursuant to Grant Program 2.

Foundation represents that Foundation Director will obtain an appraisal stating that the fair market value of the three works of art previously purchased by Foundation Director from Collaborating Artist 1 was not more than the amount paid by Foundation Director and that Foundation Director will provide a copy of the appraisal to Foundation. The appraisal will be performed by an individual who provides a declaration: (1) that the appraiser holds himself or herself out to the public as an appraiser and performs appraisals on a regular basis; (2) that states the appraiser's qualifications, including background, experience, education, and membership, if any, in professional associations; (3) that the appraiser is qualified to make appraisals of the type of property being valued; and (4) that the appraiser is not a disqualified person with respect to Foundation, a party to the transaction in which Foundation Director acquired the art, a person employed by the foregoing persons, a person related to any of the foregoing persons under § 267(b), or a person who is in a relationship described in § 267(b) with any of the foregoing persons. Further, Foundation represents that neither Foundation nor Foundation Director has knowledge of facts that would cause a reasonable person to expect the appraiser to overstate the value of the works of art.

Foundation represents that at the time of Foundation Director's purchase from Collaborating Artist 1, Grant Program 2 was in the early stages of consideration and formulation, and no decision had been made whether to adopt such a program or when such a program would be implemented. Foundation also represents that if a Secondary Grantee were to purchase art from Collaborating Artist 1 using funds received from X,

the Secondary Grantee's purchase will be transacted between the Secondary Grantee and Collaborating Artist 1, without involvement by X or Foundation.

RULINGS REQUESTED

Based on the stated facts and representations, Foundation has requested the following rulings:

1. Grant Program 2 grants will be qualifying distributions within the meaning of § 4942.
2. Grant Program 2 grants will not be taxable expenditures within the meaning of § 4945.
3. Grant Program 2 grants will not be a transfer of Foundation assets for the benefit of Foundation Director within the meaning of § 4941(d)(1)(E).

LAW AND ANALYSIS

Issues 1 and 2 – Whether Grant Program 2 grants will be considered qualifying distributions under § 4942 and not taxable expenditures under § 4945.

Section 4942(a) imposes a tax on the undistributed income of a private foundation for any taxable year.

Section 4942(c) defines “undistributed income” to mean, with respect to any private foundation for any taxable year as of any time, the amount by which (1) the distributable amount for such taxable year exceeds (2) the qualifying distributions made before such time out of such distributable amount.

Section 4942(g)(1)(A) defines “qualifying distribution” to mean, in part, any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in § 170(c)(2)(B), other than any contribution to an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons.

Section 4945 generally imposes a tax on taxable expenditures made by a private foundation.

Section 4945(d)(4) provides that a grant by a private foundation to an organization (other than a grant to a public charity described in § 509(a)(1) or (2), to a supporting organizations described in § 509(a)(3) (other than one described in clause (i) or (ii) of § 4942(g)(4)(A)), or to an exempt operating foundation described in § 4940(d)(2)) will be a “taxable expenditure” unless the private foundation exercises expenditure responsibility over the grant pursuant to § 4945(h). In addition, § 4945(d)(5) provides that a “taxable expenditure” includes any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B).

Section 4945(h) provides that expenditure responsibility referred to in § 4945(d)(4)(B) means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

Section 170(c)(2)(B) lists the following purposes: “religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition ..., or for the prevention of cruelty to children or animals.” These purposes are the same purposes listed in § 501(c)(3) (excluding testing for public safety).

Example 4 of Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii) states that museums, symphony orchestras, and similar organizations are considered educational organizations within the meaning of § 501(c)(3).

Treas. Reg. § 53.4942(a)-3(a)(3) states that “an organization is ‘controlled’ by a foundation or one or more disqualified persons with respect to the foundation if any of such persons may, by aggregating their votes or positions of authority, require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable.”

Example 3 of Treas. Reg. § 53.4942(a)-3(a)(8) provides that a private foundation’s purchase of an additional building to be used to exhibit paintings for the public is a qualifying distribution.

Treas. Reg. § 53.4942(a)-3(c)(4) provides that where a donee of a private foundation uses contributed funds to make a subsequent payment to a “secondary donee,” such subsequent payment will not be treated as a contribution by the private foundation to the “secondary donee if the distributing foundation does not earmark the use of the contribution for any named secondary donee and does not retain power to cause the selection of the secondary donee by the [original donee].” Even where the private foundation “has reason to believe” that a secondary donee would benefit from a contribution, the foundation will not be deemed to have made a contribution to such secondary donee “so long as the original donee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of such foundation.”

Similar to Treas. Reg. § 53.4942(a)-3(c)(4), Treas. Reg. § 53.4945-5(a)(6)(i) provides that where a grantee of a private foundation uses grant funds to make a subsequent payment to a “secondary grantee,” such subsequent payment will not be treated as a grant by the private foundation to the “secondary grantee if the foundation does not earmark the use of the grant for any named secondary grantee and there does not exist

an agreement, oral or written, whereby such grantor foundation may cause the selection of the secondary grantee by the [original grantee]." Even where the private foundation "has reason to believe" that a secondary grantee would benefit from a grant, the foundation will not be deemed to have made a grant to such secondary grantee "so long as the original grantee organization exercises control, in fact, over the selection process and actually makes the selection completely independently of the private foundation."

Treas. Reg. § 53.4945-5(b)(3) states that "in order to meet the expenditure responsibility requirements of section 4945(h), a private foundation must require that each grant to an organization, with respect to which expenditure responsibility must be exercised under this section, be made subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization. Such commitment must include an agreement by the grantee: (i) to repay any portion of the amount granted which is not used for the purposes of the grant, (ii) to submit full and complete annual reports on the manner in which funds are spent and the progress made in accomplishing the purposes of the grant, except as provided in paragraph (c)(2) of this section, (iii) to maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and (iv) not to use any of the funds...(c) to make any grant which does not comply with the requirements of section 4945(d)(3) or (4)."

Treas. Reg. § 53.4945-6(b)(1)(v) provides, in part, that any payment that constitutes a qualifying distribution under § 4942(g) ordinarily will not be treated as a taxable expenditure under § 4945(d)(5).

Rev. Rul. 64-174, 1964-1 C.B. 183, held exempt under § 501(c)(3) an organization that created interest in theatre by aiding local communities to establish their own charitable and educational repertory theatres. The Service reasoned that cultural organizations devoted to the promotion of the arts may qualify for exemption as educational or charitable. See also Rev. Rul. 64-175, 1964-1 C.B. 185.

Rev. Rul. 66-178, 1966-1 C.B. 138, held exempt under § 501(c)(3) an organization created to foster and develop the arts by sponsoring a public art exhibit at which the works of unknown but promising artists were selected for public display.

Foundation has represented that grants to be made pursuant to Grant Program 2 will not be earmarked for the use of any Secondary Grantees and Foundation will not retain any power to cause the selection of any Secondary Grantee by X. Foundation has represented that neither it nor any disqualified persons with respect to it control X (directly or indirectly) within the meaning of Treas. Reg. § 53.4942(a)-3(a)(3). Further, Foundation has represented that X will exercise control, in fact, over the Secondary Grantee selection process and make the selection completely independently of Foundation. Accordingly, the proposed grants from Foundation to X will be treated as grants from Foundation to X and not grants from Foundation to Secondary Grantees.

Foundation has represented that Foundation will exercise expenditure responsibility with respect to grants to X in accordance with the requirements of § 4945(h) and Treas. Reg. § 53.4945-5(b)(3). Pursuant to expenditure responsibility agreements, Foundation will require X to maintain the grant funds in a separate fund dedicated to purposes described in § 170(c)(2)(B), in accordance with Treas. Reg. § 53.4945-6(c).

Grants made pursuant to Grant Program 2 will be made exclusively to fund grants made by X to Secondary Grantees, which will fund the purchase of art works for public display by Secondary Grantees. X is a national organization established to acquire works of art and items of historical importance for public display by other, local public institutions (such as Secondary Grantees). Foundation represents that both X and all of the Secondary Grantees are or will continue to be public, nonprofit organizations no part of the net earnings of which inure to the benefit of any private shareholder or individual. It has long been the position of the Internal Revenue Service that so-called “cultural” organizations may be exempt under § 501(c)(3) if they further educational or charitable purposes. See, for example, Example 4 in Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii), Rev. Rul. 64-175, and Rev. Rul. 66-178. Similarly, certain cultural activities, such as the purchase of art works for public display, further educational or charitable purposes under § 170(c)(2)(B). Accordingly, the proposed grants from Foundation to X will be treated as amounts paid to accomplish one or more purposes described in § 170(c)(2)(B).

Therefore, grants to be made by Foundation to X pursuant to Grant Program 2 will be qualifying distributions because they will be made exclusively for § 170(c)(2)(B) purposes.

Similarly, grants made by Foundation to X pursuant to Grant Program 2 will not be taxable expenditures because they will be made exclusively for § 170(c)(2)(B) purposes and Foundation will exercise expenditure responsibility with respect to the grants.

Issue 3 – Whether, given Foundation Director’s purchase of art from Collaborating Artist 1, Grant Program 2 grants will be transfers of Foundation assets for the benefit of Foundation Director within the meaning of § 4941(d)(1)(E).

Section 4941 imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) provides that the term “self-dealing” includes any direct or indirect “transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.”

Section 4946(a)(1)(B) defines the term “disqualified person” to include, with respect to a private foundation, a foundation manager.

Section 4946(b) provides that a “foundation manager” includes an officer, director, or trustee of a foundation.

Treas. Reg. § 53.4941(d)-1(b)(5) states that, for purposes of indirect self-dealing, “an organization is controlled by a private foundation if the foundation or one or more of its foundation managers (acting only in such capacity) may, only by aggregating their votes or positions of authority, require the organization to engage in a transaction which if engaged in with the private foundation would constitute self-dealing. Similarly, for purposes of this paragraph, an organization is controlled by a private foundation in the case of such a transaction between the organization and a disqualified person, if such disqualified person, together with one or more persons who are disqualified persons by reason of such a person’s relationship (within the meaning of section 4946(a)(1)(C) through (G)) to such disqualified person, may, only by aggregating their votes or positions of authority with that of the foundation, require the organization to engage in such a transaction.”

Treas. Reg. § 53.4941(d)-2(f)(1) states, in part, that the purchase or sale of stock or other securities by a private foundation shall be an act of self-dealing if such purchase or sale is made in an attempt to manipulate the price of the stock or other securities to the advantage of a disqualified person.

Treas. Reg. § 53.4941(d)-2(f)(2) states, in part, that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing.

In Rev. Rul. 77-371, 1977-2 C.B. 388, a private foundation gave a grant to a public charity to establish a student loan guarantee program. Under the terms of the program, the public charity agreed to guarantee loans only for children of the private foundation’s employees, some of whom were disqualified persons. The IRS held that “[e]ach time a loan made to a disqualified person is guaranteed with funds granted by the private foundation, the income or assets of the foundation are being used indirectly to satisfy the legal obligation of a disqualified person.”

Foundation Director is a disqualified person with respect to Foundation because Foundation Director is a foundation manager. See § 4946(a)(1)(B) and § 4946(b). If Foundation assets are used or transferred through Grant Program 2 for the benefit of Foundation Manager, such a transaction would be an act of self-dealing under § 4941(d)(1)(E). While neither the Internal Revenue Code nor the Treasury Regulations contain a definition of “indirect self-dealing,” an indirect act of self-dealing can occur where grants to intermediaries result in private foundation assets being transferred for the use or benefit of a disqualified person. See Rev. Rul. 77-371.

For example, an indirect act of self-dealing would occur if the following steps were carried out pursuant to a plan: (1) Foundation Director purchases works of art from Collaborating Artist 1 at a price below fair market value (perhaps incurring a legal

obligation to pay the difference between the fair market value and the purchase price); (2) Foundation assets are transferred through Grant Program 2 to a Secondary Grantee; and (3) Secondary Grantee uses funds from Grant Program 2 to purchase works of art from Collaborating Artist 1 at a price above fair market value, intending to make whole Collaborating Artist 1 with respect to Foundation Director's prior purchase at below fair market value. In such a scenario, Foundation assets would have been transferred indirectly for the benefit of Foundation Director, either by satisfying Foundation Director's legal obligation (similar to Rev. Rul. 77-371) or by enabling Foundation Director to secure a lower purchase price.

However, the above scenario does not accurately describe the facts as presented by Foundation. First, Foundation has represented that Foundation Director's purchase price was not below fair market value and Foundation Director will receive an appraisal from an independent third-party qualified appraiser concluding that Foundation Director did not pay less than fair market value for art purchased from Collaborating Artist 1. Second, Foundation has represented that Foundation and Foundation Director do not control X or any Secondary Grantee and cannot require X or any Secondary Grantee to engage in any transaction. Third, Foundation has represented that X will act independently of Foundation and Foundation Director in its selection of a Secondary Grantee. And, fourth, Foundation has represented that Secondary Grantees will act independently of X, Foundation, and Foundation Director when purchasing Art from any Collaborating Artist. Based on Foundation's representations and statement of the facts, there is no indication that Foundation Director could influence the purchase price negotiated between any Collaborating Artist and any Secondary Grantee.

Alternatively, a Secondary Grantee's purchase and display of works of art from Collaborating Artist 1 may serve to bring increased attention and renown to Collaborating Artist 1, thereby increasing the value of the works of art previously purchased by Foundation Director. This fact does not make the provision of Grant Program 2 grants an act of self-dealing for several reasons. First, Foundation represents that at the time of Foundation Director's purchase, Foundation had not yet implemented or even formally adopted Grant Program 2. Second, Foundation and Foundation Director do not control X or any Secondary Grantee and cannot require X or any Secondary Grantee to engage in any transaction. X will act independently of Foundation and Foundation Director in its selection of a Secondary Grantee. A Secondary Grantee's purchase funded by Grant Program 2 may be of artwork from a Collaborating Artist other than Collaborating Artist 1, without the influence of Foundation or Foundation Director. Finally, even if a Secondary Grantee were to purchase artwork from Collaborating Artist 1, resulting in an increase in the value of the art previously purchased and still held by Foundation Director, such a benefit to the Foundation Director would be incidental and tenuous within the meaning of Treas. Reg. § 53.4941(d)-2(f)(2).

For the above reasons, we conclude that Grant Program 2 grants will not be transfers of Foundation assets for the benefit of Foundation Director within the meaning of § 4941(d)(1)(E).

RULINGS

Based solely on the facts and representations submitted in the request for rulings and supplemental submissions, we rule as follows:

1. Grant Program 2 grants will be qualifying distributions within the meaning of § 4942.
2. Grant Program 2 grants will not be taxable expenditures within the meaning of § 4945.
3. Grant Program 2 grants will not be transfers of Foundation assets for the benefit of Foundation Director within the meaning of § 4941(d)(1)(E).

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Foundation and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2020-1, 2020-1 I.R.B. 1, § 7.01(16)(b). This office has not verified any of the material submitted in support of the request for rulings, and such material is subject to verification on examination. The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively if: (1) there has been a misstatement or omission of controlling facts; (2) the facts at the time of the transaction are materially different from the controlling facts on which the ruling is based; or (3) the transaction involves a continuing action or series of actions and the controlling facts change during the course of the transaction. See Rev. Proc. 2020-1, § 11.05.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the proposed transaction under any other provision of the Internal Revenue Code or Treasury Regulations.

This letter is directed only to Foundation. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Foundation's authorized representatives.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Mike Repass
Senior Technician Reviewer
Exempt Organizations Branch 3
(Employee Benefits, Exempt Organizations, and
Employment Taxes)

cc: